

# Chapter 1

## The Basics

*This chapter reviews the basic skills needed to operate a small business and some common reasons small businesses fail.*

Owning and operating a small business can be a tremendously fulfilling and rewarding way of life, but it is not always an easy one. No one considering it should make the decision lightly. A great deal of thought and research should go into making a decision that will affect you and your family for a long time to come.

Many entrepreneurs have the motivation, desire and talent, do not take the time to properly investigate and research the business they are interested in starting and adequately prepare to be in business.

Similar to the game of chess, success in small business starts with decisive and correct opening moves. And although initial mistakes are survivable, it usually requires skill, discipline and hard work to regain the advantage. Some of the basic skills anyone must have to run any kind of business include:

**Basic money-management skills.** While you don't need to have a lot of money to start a business successfully, you do need the ability to make the most of the money that you have. Being able to focus on the bottom line and pay attention to the numbers is as essential as the ability to price your products and services, manage your cash flow, and make sure you collect payment for the work you do. If you are lacking in these skills you can get training in business courses, books, and so forth.

**A marketing mindset.** You aren't truly in business until you have business. No matter how much your product or service is in demand, or how great a job you do, if people don't know about you, you won't have much business. You must be able to make your business visible to the people who need it, and this means understanding marketing.

**Self-management skills.** To make it on your own, you must become a goal-directed and self-motivated individual. You must be able to get yourself started every day, stick to business, and close the door on work at the day's end.

**Time-management skills.** In your business, you will need to wear many hats, from chief executive officer to janitor. You'll have to do the business, get the business, and run the business. This means you'll need to manage your time effectively to make sure the most important and urgent things get done in a timely fashion.

**Basic office organization.** Since one of the roles you'll probably play is that of your own office administrator, you will need to be able to organize, equip, and manage your office space so that you can work effectively in it, having a place for everything and keeping everything in its place so that you can find it easily when you need it.

*Source: "The Best Home Businesses For The 90's", second edition, by Paul and Sarah Edwards, 1994, published by G.P. Putnam's Sons.*

## **WHY DO SMALL BUSINESSES FAIL?**

A study conducted by the U.S. Small Business Administration looked at reasons for small business failure. Here are the major reasons ranked according to frequency:

### **1. Inadequate front-end planning.**

No Business Plan prepared; no Feasibility Study done and no Cash Flow Projections done.

### **2. Insufficient capital for start-up and back-up.**

Even the most dedicated workaholic cannot overcome ongoing capital deficiencies due to start-up losses.

### **3. Inexperienced management.**

Insufficient experience in the management and the day-to-day operations of the business or of any business.

### **4. The wrong location.**

Low traffic, no expansion area, changing characteristics of the neighborhood. The customers are out there, but the business is not convenient because of driving and parking distance, transportation costs, employee unwillingness to live in the community.

### **5. Inventory mismanagement.**

Too much of the wrong inventory.

### **6. Too much capital in fixed assets.**

The failure to properly anticipate the cost of equipment and real estate needed to start and expand.

### **7. Poor credit practices.**

Failure to properly extend and control credit policy and practices.

### **8. Unplanned expansion.**

If one location is doing well, a second doesn't mean the business will do twice as well unless management is available.

### **9. Having the wrong attitude.**

Not ready to work longer and harder than ever before; too much money in trappings and appearance.

### **10. Inadequate records and financial knowledge.**

### **11. Unwillingness to employ and work with a banker, accountant, and a lawyer.**

### **12. Lack of managerial foresight.**

Failing to build staff to compensate for the weaknesses of the founder or owner; failing to adequately compensate second-line management.

One solution to these problems is education. For a wide-range of business training, including individual counseling and programs for groups of business people, contact your local **University Outreach and Extension Office** or **Small Business Development Center (SBDC)**.

## **WRITING A BUSINESS PLAN**

One of the first steps in a new venture is the development of a business plan. The business plan describes the business, its product or service, market, staffing and financing needs. A well prepared business plan serves several purposes:

- ◆ For the new business, it helps the owner determine the feasibility and desirability of pursuing the steps necessary to start a business.
- ◆ For the company seeking financing, it is an important sales tool for raising capital from outside investors.
- ◆ For an existing company, the business plan forms the basis of a more detailed operational plan and thus becomes an important management tool for monitoring the growth of the firm and charting future directions.

A business plan is the written expression of your business idea. It is obviously important to anyone thinking of starting a business, but is also useful for those already in business. The process of writing down everything involved in bringing the idea to reality requires dealing with all the varied aspects of that business. It forces you to take an objective look at the entire idea and should permit you to see areas that need re-thinking. The plan will help you sort through things logically and should result in a sound, usable plan with which to work.

Please refer to Chapter 2 for a more complete discussion of business plans.

## **RECORD KEEPING**

Every business, no matter what size, must keep written records of the transactions that take place. In addition to avoiding costly errors, good records tell you if you are making a profit or losing money, provide you with accurate tax information, and give you the information needed to see if and where improvements can be made. These records will be required by your financial institutions and local, state and federal government agencies, as well as for your own information. The IRS allows you to choose the method of record keeping that is best suited to your circumstances.

If you are already in business and not keeping records, start immediately. After you get your system set up, you might want to work backwards to the first of the year so that you have as complete information as possible for your year-end records. If you are starting a new business, you will need an estimate of income and expenses to secure financing if needed; or, if your own resources are adequate, you will still want to know how you are doing financially. To determine if a profit is being made, you'll need to figure your start-up costs and your operating costs. Start-up costs are the one-time expenses necessary to start your business, such as equipment expected to last a long time. Operating costs are those that keep recurring, such as purchasing materials needed for making the product.

Once your record keeping system is set up, record all transactions promptly. It is also a good idea to establish a definite time each week/month to pay bills, reconcile the bank statement, and do other tasks.

“Accounting” does not necessarily mean “keeping books”. What you really need is some organized method to track all of the business activity generated by each of your transactions and will provide you with the reports and information required by taxing and regulatory authorities.

Sound accounting practices can mean more profits. The record keeping system need not be elaborate. Too many records can be as ineffective as too few. The system used should accomplish the following:

1. Maintain a record of all business transactions through:
  - a. Daily (or periodic) summary of cash receipts;
  - b. Disbursement journal;
  - c. Business checkbook;
  - d. Employee compensation record (including withholding, Social Security, and other taxes);
  - e. General ledger (a summary of all subsidiary ledgers, including cash receipts, disbursements and other transactions); asset register (including depreciation when applicable), which should also include accounts receivable, accounts payable and an inventory system. Reflect periodic operating results and financial condition in a manner understandable by management.
2. Protect the assets of the business from errors, fraud and carelessness. Provide a basis for business planning by showing the results of past decisions and facts needed for future decisions.

The system also must be designed to generate information that is periodically required by taxing and other regulatory authorities.

There are numerous computer software programs on the market as well as accounting forms and systems. Many trade associations offer standard accounting systems for member businesses. The University Outreach and Extension offices and Small Business Development Centers frequently teach classes on record keeping.

If you wish, you can consult an accountant for assistance in setting up an accounting system, or hire one to do your books for you. If you need assistance in locating an accountant, you can contact: Missouri Society of Accountants at 1-800-959-4276.

## CHECKLIST FOR GOOD RECORDS

✓ **Open a business checking account.** Don't use your personal checking account for your business. The cost of another account is minimal compared to the confusion of business matters in your personal account.

✓ **Pay all bills by check.** On each check note what was purchased with that check. This is your record of having paid bills and enables analysis of expenditures.

✓ **Use petty cash sparingly.** Only when absolutely necessary should you make payments from petty cash and then be sure you have a receipt including the purpose of each expenditure. Then write a check to petty cash to keep the checkbook complete.

✓ **Record all sales.** Use sales tickets, duplicate receipts, copies of invoices, cash register tape, or some other system that itemizes each sale. This enables analysis of sales and provides a record of who has paid or not paid.

✓ **Endorse all checks immediately.** Endorse checks "for deposit only" to your account in your bank.

✓ **Deposit receipts often.** Don't keep cash or checks around your place of business. They invite theft, they can get lost, and the money should be put to work for you immediately.

✓ **Label bank deposit slips completely.** They provide a good record of sources of income and back up sales records.

✓ **Balance bank account monthly.** Do it when the statements come from the bank.

✓ **Inventory all items regularly.** Count all items in inventory and include the purchase cost of each item. Absolutely, take inventory once a year. A good business practice is to take inventory twice a year and better practice is quarterly inventory.

## PROFESSIONAL SERVICES

It is always advisable to enlist the services of an accountant and a lawyer when considering a new business operation. Their advice and guidance can help you choose the form of business organization best suited for your particular situation, thus increasing the chances of business success.

### Lawyer



Your lawyer should be experienced in business matters. Ask your banker to recommend a law firm or individual lawyer. Ask other successful business owners who they use. Be sure to discuss fees in the initial interview, and ask if he/she represents businesses similar to yours. A reputable lawyer will welcome an open discussion on both subjects. Do not feel obligated to hire the first lawyer with whom you discuss your business plan. Find one with whom you are comfortable and you feel you can trust.

Another way to find a competent attorney is through the Missouri Lawyer Referral Service operated by the Missouri Bar Association. Their attorneys will confer with you for up to 30 minutes for a fee of \$25. The telephone numbers are:

Kansas City: 816/221-9472 (Clay, Jackson, Platte and Ray counties)

St. Louis City and County: 314/621-6681

Jefferson City: 573/636-3635 (out-state Missouri)

Springfield: 417/831-2783 (Greene County only)

### Accountant



Although an accountant is not mandatory for starting a new business, it is highly recommended that one be consulted. Again, seek recommendations from your lawyer, banker and other business associates. Don't feel obligated to hire the first accountant that you interview.

For assistance in locating an accountant, contact the Missouri Society of Accountants, 6132 Blue Ridge Blvd., Raytown, Missouri 64133; 1-800-959-4276.

# CHECKLIST FOR STARTING A NEW BUSINESS

*As you proceed through the process of starting your business, use the following checklist as a guide to make sure that you have covered all the requirements for starting your business.*

- ☐ Prepare a written **business plan**, including a **marketing plan**.
- ☐ **Estimate your start-up costs** (see [Worksheet #1](#))
- ☐ Select an **attorney and accountant**
- ☐ Obtain **local business licenses** through the city or county government – contact the city clerk and/or county clerk for assistance on local requirements.
- ☐ Check on local **zoning** ordinances, regulations, building permits and fire codes through the city or county government.
- ☐ Determine whether your business requires a **state or federal license or permit** to operate. Also check on state or federal regulations that may affect your business. Refer to [Legal Formation](#) for more information on state and federal requirements.
- ☐ Select a **banking institution** and open a business account.
- ☐ Select your **business fiscal year**.
- ☐ Selecting a name for your business is one of the most important decisions you can make. While there are many considerations in selecting a name, one is the legal availability of the name.

Limited Partnerships, Limited Liability Companies and Corporations have legal protection of their business name when they file their registration with the Missouri Secretary of State. Since there can be no duplication of names for these types of entities, you may want to check on the availability of your selected name either through the Secretary of State's website (<http://www.sos.state.mo.us/BusinessEntity/>) or by calling (573) 751-3317.

Sole proprietorships and partnerships are required to file a "fictitious name registration" with the Secretary of State's Office; however, this registration does not afford the business legal protection of their business name – e.g., there can be multiple sole proprietorships/partnership with the same business name. Since there is no name protection, name availability checks will not be done.

- ☐ You will need to apply for a **sales tax number** or **use tax** ([Form 2643](#)) if you will be selling merchandise at retail or wholesale.
- ☐ You may need a **Federal Employer Identification Number** (FEIN) ([SS-4](#)) (and [instructions](#)).

## If hiring employees:

- ☐ Create a clear job description for each position.
- ☐ Determine the wage and hour laws from the state and federal government.

- ☐ Obtain a Federal Employer Identification Number (FEIN) using IRS Form [SS-4 \(instructions\)](#).
- ☐ Obtain a Missouri Employer Withholding number using MoDOR [Form 2643](#) (Missouri Department of Revenue 573-751-5752).
- ☐ File [Form 2699](#) to determine liability status for Missouri Unemployment tax (Missouri Division of Employment Security 573-751-3328).
- ☐ Check the requirements on Worker's Compensation Insurance with the state – Missouri Division of Worker's Compensation 573-775-2667.

More information on [hiring](#) requirements.

Once you have hired:

- ☐ Have each employee complete an [I-9 Form](#) (Employment Eligibility Verification).
- ☐ The employer must display appropriate work posters informing employees of their rights
- ☐ The employee must complete the IRS [Form W4](#) and a Missouri Form [MoW4](#). The IRS form must be kept on file and the Missouri form must be sent to the Missouri Department of Revenue within 20 days of hiring
- ☐ The employee must complete INS [Form I-9](#) and provide proof of citizenship. The employer must keep this form in a separate file.
- ☐ Employees should complete time cards for each pay period.
- ☐ With the first payroll the employer must:
  - withhold state income tax and federal income tax.
  - withhold 6.2% of the employees salary for Social Security taxes.
  - withhold 1.45% of the employees salary for Medicare taxes
  - pay amounts matching the Social Security and Medicare with holding for each employee.
  - make monthly payment of these taxes to an approved banking institution.
- ☐ Contact an **insurance** agent regarding fire, accident, liability, theft, and other types of commercial insurance and obtain the appropriate insurance for your business.
- ☐ Find out how **OSHA** laws affect your business.
- ☐ Join a **professional association or organization** (e.g, Chamber of Commerce)
- ☐ You may need to make quarterly estimated **income tax** payments to the IRS and self-employment tax payments.
- ☐ If forming an S Corporation, file [Form 2553](#) (and [instructions](#)) with the IRS within 75 days.

Special requirements for Corporations and LLCs:

- ☐ Corporations hold an organizational meeting:
  - By-laws are adopted
  - Board of Directors is elected
  - Share certificates that have been purchased are distributed and recorded on the corporation's stock ledger
  - Record minutes of the meeting

- Elect corporate members, managers and/or officers

☐ An LLC holds an organization meeting:

- Operating agreement is adopted
- Membership certificates are distributed
- Record minutes of the meeting
- Company members and/or managers are elected